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Chapter 7
The IPSASB's conceptual framework and views on selected national frameworks

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Summary

This chapter is about conceptual frameworks in public sector accounting. While particularly taking the IPSASB's conceptual framework as a reference, the chapter also offers brief views on selected national frameworks from a group of European countries – namely the UK, Finland, Austria, Germany and Portugal – as illustrative examples of how conceptual frameworks can approximate or diverge from that of the IPSASB.

The explanations enable an understanding of the role of a conceptual framework underlying public sector accounting standards, as well as the main issues normally included in it.

Keywords

Financial information, users, qualitative characteristics, elements of financial statements, measurement criteria.

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Introduction

Financial reporting standard setters across the globe have designed a number of accounting conceptual frameworks (CFs) over time, also attempting to provide a definition. The literature has presented several definitions for a CF in accounting, emphasizing different elements, either focusing on its contents, or on its purposes.[1] A CF should be perceived as a system of practical reasoning, allowing both forward and backward reasoning. Forward reasoning by standard setters to anticipate situations that would require judgmental decisions concerning accounting concepts; and backward reasoning by preparers to relate to the intentions of the standard setters.[2]

The beginnings of accounting CFs may be found in the 1930s in the USA, originating in the accounting profession. A clear attempt to reach an accounting theory was the American Accounting Association's 1966 "*A Statement of Basic Accounting Theory*" *(ASOBAT)*[3], far beyond the development of accounting theory in Europe (see Chapter 2 in this book). However, it was not until 1973, with the creation of the Financial Accounting Standards Board (FASB), the third standard setter established by the Securities and Exchange Commission (SEC) in the United States, that accounting CFs began to be discussed and developed across countries, starting from the Anglo-Saxon world.

FASB's CF, started in 1973, was the major and most complete one, comprising several statements on a wide range of financial accounting and reporting matters (e.g., objectives of financial reporting, qualitative characteristics of accounting information, elements of financial statements, recognition and measurement in financial

[1] Vela Bargues (1992).

[2] Dennis (2018).

[3] Jones (1992).

statements, and presentation of financial statements). This work has inspired others, such as the Accounting Standards Committee in UK, and the International Accounting Standards Board (IASB).

As for public sector accounting (PSA), the origins of its CFs come from the USA as well, being derived from those of business accounting, at least in the last forty years. Distinguishing between federal accounting and governmental accounting for state and local level, the latter followed, since the 1930s, principles and standards issued by a national council (currently the Governmental Accounting Standards Board – GASB). However, at the beginning of the 1980s, the FASB, which was concerned explicitly with business organizations, started to concern itself with nonbusiness organizations too, issuing a statement on the objectives of financial reporting by nonbusiness organizations, conflicting with GASB's responsibilities.[4]

Nowadays, GASB focuses on state and local government accounting, including not-for-profit public sector units. Since its establishment in 1984, GASB has initiated its own CF, starting from the FASB's framework. Currently, some important pronouncements are GASB Concept Statements no. 1 (Objectives of Financial Reporting, 1987), no. 4 (Elements of Financial Statements, 2007) and no. 6 (Measurement of Elements of Financial Statements, 2014). At the federal level, there is the Federal Accounting Standards Advisory Board (FASAB) *Handbook of Federal Accounting Standards and Other Pronouncements* (last amendment in 2021), including the Statements of Federal Financial Accounting Concepts no.1 to no.9.

While, in principle, there should be only one commonly accepted (financial) accounting theory, historically derived from practice, it is acknowledged that, even within business accounting, developing a single generally accepted accounting CF is not easy. Considering

[4] Jones (1992).

that accounting is to be a purposive activity, aimed at producing and reporting information that must be useful for somebody to do something,[5] the development of accounting CFs has been based on approaches considering the users of financial accounting reports and their needs,[6] which, in turn, are determined by the context where they act. Environment is deemed to determine the objectives of accounting information and consequently other dimensions of the accounting CF.[7]

This explains why, although based on business accounting, specific CFs have been especially derived and developed for PSA. Even those who argue for 'one single world of accounting' recognize that there may be context specifics determining PSA particularities, hence requiring its CF to reflect differences (e.g., different concepts and different interpretations of principles), at least at a detailed level, from the one for financial accounting overall.

Accordingly, though deriving from the IASB's CF, the IPSASB (2014) published a specific CF for PSA, considering the following public sector specific characteristics:[8]

- The primary objective of delivering public services – rather than to make profits and generate a return on equity for investors; requires information beyond financial position, financial performance and cash flows, to properly evaluate the performance of public sector entities;
- Non-exchange transactions (e.g., taxes and grants) – the involuntary and compulsory nature of major contributions makes accountability an overriding purpose of GPFRs;

[5] Jones and Pendlebury (2010).

[6] Jones (1992).

[7] Vela Bargues (1992).

[8] See IPSASB (2014, preface).

– A budget to be accomplished – considering the budget as an instrument of public policy and a law, GPFRs must report on the budget (public policies) accomplishment;
– Nature of the programs and longevity of the public sector – financial statements have to be complemented with information allowing the assessment of sustainability in the long run, and the going concern principle cannot be assessed only by the net financial position;
– Nature and purpose of public sector assets and liabilities – there are infrastructure and other public domain assets (e.g., heritage, military assets) difficult to measure and with no market; entities assume certain liabilities in order to provide a public service (e.g., the provision of social benefits);
– The regulatory role of public sector entities – in order to safeguard public interest or bring the market to function; judgment is required to evaluate whether the regulatory role creates assets or liabilities;
– Relationship to statistical reporting – public sector accounts, namely concerning the General Government Sector, are input for the National Accounts and Government Financial Statistics – convergence is desirable but differences remain.

In the European context, some diversity can be found regarding public sector accounting CFs. While the UK is IFRS-based (e.g., *the Government Financial Reporting Manual – FReM*, revised on an annual basis), in Continental countries there are some IPSASB's adopters (e.g., Spain, Portugal, France and Austria), whereas others are based on deeply-rooted national traditions (e.g., Germany and Finland).

This chapter focuses on financial accounting and continues discussing the definition and role of a CF and the authority of the IPSASB's CF over the standards or recommended practice guidelines (RPGs). It follows by presenting and explaining the main topics addressed in the IPSASB's CF: the objectives, users and qualitative characteristics of the GPFR information; and the definitions, recognition and measurement criteria for the elements within the financial statements. Then, it presents a comparative-international analysis of the principal topics/concepts included in the frameworks of a group of European countries (Austria, Finland, Germany, Portugal and the UK) taking the IPSASB's CF as a benchmark. Finally, it briefly addresses the work currently in progress in regards to the revision of the IPSASB's CF.

2. The role of the CF *versus* the public sector accounting standards

The actual definition of a CF remains elusive.[9] There are, however, commonalities pointing to a definition of a CF that, in the first place, embraces accounting objectives that will guide the establishment of fundamental principles and key concepts. The latter will then be followed by more procedure-oriented standards.

The IPSASB's CF presents a definition as a basic theoretical structure addressing the main elements of the financial statements, which

> establishes the concepts that underpin general purpose financial reporting [...] by public sector entities that adopt the accrual basis of accounting.[10]

The elements of financial statements are assets, liabilities, revenue, expenses, net financial position, ownership contributions and ownership distributions, for which the CF also outlines recognition and measurement criteria to be considered overall in the standards.

[9] Dennis (2018).

[10] IPSASB (2014, CF 1.1).

The CF also defines the objectives and main users of GPFRs, and the qualitative characteristics of financial information.

The IPSASB's CF applies to GPFRs of governments at all levels, international organizations, as well as to other public sector entities (except for commercial public sector entities).

Historically, because Anglo-Saxon accounting theory has developed from practice,[11] CFs follow the standards, and not the opposite; meaning that, the CFs were published after the standards were developed. Therefore, reasons for the existence of accounting CFs include: i) the need to have harmonized concepts – a common explicit theoretical reference (set of concepts and principles based on postulates or premises) capable of giving coherence to accounting practices, and on which rules (standards) and recommendations must rest; and ii) to give legitimacy to the standards themselves and to the work of standard-setters.[12]

Therefore, the CF is not a standard. It does not offer (binding) guidance for recognizing, measuring, presenting and disclosing specific transactions or topics. Although even the IPSAS are not binding, their requirements are considered as more authoritative; and in cases of conflict between IPSAS and the CF, the standards' requirements prevail.[13]

Overall, the main purposes and importance of a CF in PSA may be summarized as:

– To support *preparers* of the financial statements, in the application of (accrual-based) PSA standards (e.g., IPSAS and future EPSAS) and in the accounting treatment of topics that become relevant as a matter of the standards;
– To help in forming an opinion about the compliance of the financial statements to the standards (*auditors'* perspective);

[11] Jones and Pendlebury (2000).

[12] Jones (1992); Jones and Pendlebury (2000).

[13] IPSASB (2014, CF 1.2-1.3).

– To support *users* in the interpretation of the information within the financial statements prepared by public sector entities; and
– To offer PSA *standard-setters* the proper concepts needed to prepare PSA standards.

CFs are conventionally concerned with financial accounting. They do not address management accounting, because they are concerned with accounting for external providers of finance.[14] They do not embrace budgeting either, perhaps because budget theory has much to do with political science and also with economics, particularly public finance, which do not seem so attractive for accounting theorists (academics/researchers) and even less for professionals.

Nevertheless, in some jurisdictions, like in Portugal, there was a need to create a CF also for budgetary (cash-based) accounting and reporting, defining specific principles and terms. Some terms with a similar designation in financial accounting have different meanings in budgetary accounting, for example, revenue/expenditure, current/non-current, financial assets/liabilities.[15]

The IPSASB's CF does not refer particularly to budgetary reporting. However, as explained in Chapter 3 of this book, the scope of GPFRs admittedly embraces information and statements to report also on how budgets have been accomplished.

3. The IPSASB's CF

At the time of writing, the IPSASB's CF is the only one existent for public sector accounting at an international level, with wider ge-

[14] Jones and Pendlebury (2000).

[15] See Decree-Law 192/2015, of 11 of September – NCP 26, PORTUGAL, DECRETO-LEI n.º 192/2015, Sistema de Normalização Contabilística para as Administrações Públicas (SNC-AP).

ographic scope and resorting to the CFs from the FASAB, the GASB, and especially that of the IASB, as sources of inspiration. Therefore, the remainder of this chapter concentrates on the IPSASB's CF as the main international benchmark.

Like the IPSAS, the CF is not obligatory at any national level, as the IPSASB does not have enforcement power; to be in force, IPSAS must be endorsed, i.e. formally and/or legally adopted by each country or jurisdiction.

3.1. Objectives and main users of financial reporting

Most of the CFs for Anglo-Saxon national governments (UK, US, Australia and NZ) developed during the 1980s took a user approach, implying that the objectives of GPFRs, hence their usefulness, have been determined by the users' needs, considering integral and differential approaches.[16] Some criticisms have been made, in regard to the fact that the users and needs considered are, in reality, potential; they do not result from empirical studies, but rather from assertions and normative approaches.[17] The lack of 'verifiability' is

> (...) symptomatic of a continuing problem with the user/user needs approach of financial reporting theory: we are still not clear that a substantial number of users exist.[18]

Due to the difficulties in identifying who the real users of public sector GPFRs are, ultimately, one could say that, in a democratic regime, everyone in the population could be assumed to be a user or

[16] Jones and Pendlebury (2000).

[17] Jones (1992); Rutherford (1992).

[18] Jones and Pendlebury (2000, p. 138).

potential user of the accounts of public sector organizations. This, however, would create serious problems in identifying their information needs and defining statements in order to satisfy them. Still, in democratic contexts, there is a governmental duty to be publicly accountable, so accountability is an implicit objective of public sector GPFRs, regardless of who the users are and what their needs might be.[19] In fact, various literature highlight that the objective of accountability is of paramount importance in the public sector context.[20]

Given that GPFRs in the public sector seem to be particularly oriented to external users, decision-making needs have been added and explicitly considered in CFs, also derived from business accounting in Anglo-Saxon countries. There are differences between the two objectives: accountability and decision usefulness. Accountability (past-oriented) is considered to be more generic than decision usefulness (future-oriented), which points to specific purpose financial reports, as illustrated in Figure 7.1. Balancing the two purposes is rather tricky.

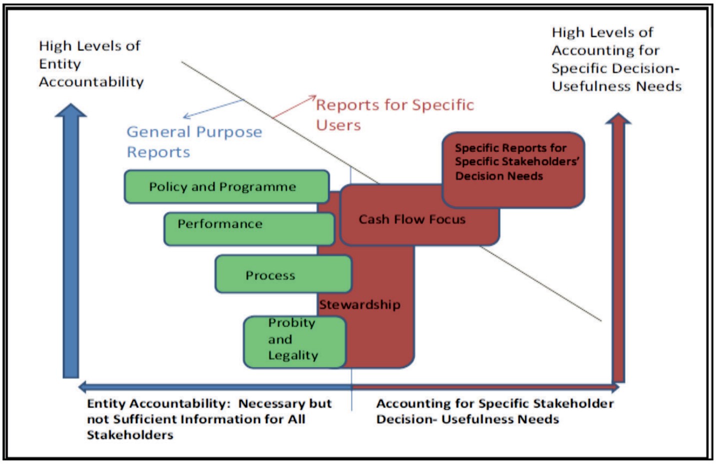

Figure 7.1: Differences between accountability and decision usefulness
Source: Laughlin (2008, p.249)

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[19] Jones and Pendlebury (2000).

[20] See for example, Chan (2003).

Additionally, users' needs (GPFRs purposes) for accountability and decision-making seem to be rather controversial within the public sector context. For example, Jones (1992, p.260) explains that the 'accountability' notion should somehow have implicit the 'decision-making':

> (...) accountability must imply some purpose for some external user and that, however casual the decision might be, the purpose must lead to a decision: if the accountee is entirely passive, accountability surely must be an empty notion.

Moreover, even if

> There is no difficulty in identifying parties who are unequivocally external to a public sector organisation who might in principle be users of financial reports (*e.g., taxpayers, voters, service recipients, investors*). (...) There is, however, a difficulty in identifying the decisions which a rational actor falling within one of these classes might seek to take by employing the general purpose statements of any government unit. [italics provided][21]

Rutherford (1992) argues that there are no rational reasons to consider that citizens, even as voters and taxpayers, are indeed users of information for decision making, although it might be admissible that certain experts, such as the *media* and policy analysts, are users of public sector financial information on their behalf. However, in the context of control and accountability, the author admits a variety of intermediate users who might be considered internal from one perspective and external from another. Politicians in central government are an example: they are internal users as decision-makers within the government on the one hand, but they are external users while

[21] Rutherford (1992, p. 267).

exerting their oversight role on lower level governments or agencies. Parliamentarians are another example: in principle, they are capable of demanding any information they want; nonetheless, in practice, they exert a limited power of control, making them act as external users, using the financial reports of government and public sector entities at large for the purposes of assessing accountability and general compliance with the legislation (e.g., budgetary restrictions).

Getting around these controversies, the IPSASB has followed a normative and prescriptive approach while addressing the objectives and users of GPFRs. Accordingly,

> The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes.[22]

Laughlin (2008) points out that the IPSASB makes use of the word 'accountability' rather than 'stewardship'. This implies that accountability is used in order to include the concept of stewardship in the framework.

Several (potential) users are considered, distinguishing between primary users and others, as in Table 7.1.

Primary users	Other users
Service recipients and their representatives **Taxpayers** and their representatives **Resource providers** (investors/markets, donor agencies, …)	Government statisticians Analysts and financial advisors Media Regulators and oversight bodies Audit institutions and control bodies (e.g., General Audit Office; Court of Audit, …) Parliamentary or government committees Public interest and lobby groups and others (e.g. rating agencies; entity management, …)

Table 7.1: Users of GPFRs
Source: IPSASB (2014, CF 2)

[22] IPSASB (2014, CF 2.1).

> do not possess the authority to require a public sector entity to disclose the information they need for accountability and decision-making purposes.[23]

Politicians are the representatives of service recipients, taxpayers and citizens at large. They are assumed to make extensive and ongoing use of GPFRs when acting in that capacity.[24]

In view of the above discussion, questions may arise about whether all those considered by the IPSASB are, in reality, users of GPFRs in the public sector, or whether they are only 'addressees' or stakeholders. Given that the discussion about financial information users and their needs is a recurring topic in the accounting field, recently there has been another attempt to shed some light on the matter, particularly addressing the use by politicians.[25]

Despite the lack of empirical evidence, the IPSASB assumes the following as the main information needs of users of GPFRs in the public sector:[26]

1. Performance (accomplishment of operational and financial objectives; resource management; compliance with regulation and laws);
2. Liquidity and solvency of the entity;
3. The sustainability of the entity's service delivery and other operations over the long term;

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[23] IPSASB (2014, CF 2.4).

[24] IPSASB (2014, CF 2.4).

[25] See, for example, Jorge et al. (2016) and other authors in that issue. See also Haustein et al. (2019) and other authors is that issue, and Budding and Van Helden (2022) and other authors in this theme.

[26] IPSASB (2014, CF 2.11-2.13).

4. Whether resources are used economically, efficiently, effectively and as intended;
5. Whether the volume and cost of services provided during the reporting period are appropriate;
6. Whether levels of taxes or other resources raised are sufficient to maintain the volume and quality of services;
7. How current operations are being funded (taxes, borrowing, other sources…); and
8. Future funding needs and sources.

While 1 to 3 are common to both service recipients and resource providers, 4 to 6 are more specific to the former and 7 and 8 to the latter.

3.2. Main accounting principles

There are main accounting principles constituting important postulates or assumptions in PSA, the interpretation of which may be different from that in business accounting. Even if generally developed in other chapters in this book, these principles – **accrual**, **going concern** and **substance over form** – are addressed here, within the IPSAS perspective.

Like in business accounting, in PSA under IPSAS the **accrual concept** prevails in financial accounting – transactions are recognized when they occur (and not when cash or equivalent is received or paid); transactions and events are recorded and recognized in the financial statements of the periods to which they relate. Elements to be recognized are assets/liabilities, expenses/revenues and net assets/equity.[27] Still, the application of the matching concept[28] required

[27] IPSASB (2022, IPSAS 1.7).

[28] The matching concept is particularly important in accrual accounting. It requires that revenues and expenses in a period to be related, so that the resulting surplus/deficit reported for a period is comprehensive. This concept is based on the

under this principle is problematic in public sector organizations, questioning the meaning of the deficit/surplus in the financial performance statement and raising a need to consider non-financial performance reporting as a complement (see Chapter 14 in this book).

Unlike IFRS-based business accounting, under IPSAS, a cash concept may also be used in financial accounting. Within most European countries, this prevails in budgetary accounting, recognizing transactions only when cash or equivalent is received or paid; statements provide information on sources of cash raised during the period, the purposes for which cash was used, and the balance at the reporting date. Elements to be recognized are cash expenditure – payments, and cash revenue – receipts.[29]

Still, overall, budgetary accounting is not a synonym of cash accounting; in fact, budgetary accounting may also be accrual-based (e.g., in UK and Austria, and in some German local governments), and in accrual-based reporting there is cash-based information too, such as in the cash-flow statement.

Another important principle is the **going concern**, by which

> Financial statements must be prepared on a going concern basis, unless there is an intention to liquidate the entity or to cease operating, or if there is no realistic alternative but to do so.[30]

While this appears to be similar to business accounting, a different interpretation is required in the public sector context: instead of considering financial viability issues (essentially reflected in the net financial position), a long-term perspective of financial

premise that a reporting entity must incur expenses in order to generate revenue. This does not fit to (most of) the public sector – there are no expenses needed to generate tax revenue.

[29] IPSASB (2022, Cash Basis IPSAS 1.2.2).

[30] IPSASB (2022, IPSAS 1.38).

sustainability must be considered, pointing to continuity in public service provision.

As in businesses, material uncertainty may raise doubts about an entity's ability to continue operating. Yet, in the public sector, besides the tests of liquidity and solvency, other (non-financial) issues (e.g., power to levy taxes, multi-year funding agreements, merging, restructuring, etc.) are also relevant. The going concern concept, therefore, relates to the ability of maintaining public service provision as expected.[31]

Finally, there is the **substance-over-legal-form** principle,[32] by which

> Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance – which is not necessarily always the same as its legal form.[33]

The legal form is associated to ownership that may lead, e.g., to the legal ownership of assets, such as administrative buildings owned by municipalities.

While substance-over-legal-form has been a generally accepted accounting principle in business accounting, in the public sector it is not, as such. The legality principle is linked to traditional PSA; therefore, it has prevailed in some jurisdictions, like in Portugal, although substance over legal form was considered applicable in particular cases (for example, financial leases and public domain assets). As a general principle underlying IPSAS, it has significant

[31] See IPSASB (2022, IPSAS 1) and IPSASB's *Recommended Practice Guideline 1 – Reporting on the Long-Term Sustainability of an Entity's Finances*.

[32] This is an implicit principle in the IPSASB's CF, underlying the qualitative characteristics of faithful representation.

[33] IPSASB (2014, CF 3.10).

implications in jurisdictions where the legality principle used to override (e.g., Portugal). An IPSAS-based accounting system implies control criteria related to the ability to use the resources so as to derive service potential or economic benefits, to prevail over ownership and legal-based control criteria. Consequently, substantial changes in asset recognition are expected in countries where the legality principle used to prevail, because public sector entities often have control over several assets, namely buildings and infrastructures, of which they may not be legally owners.

3.3. Qualitative characteristics (and main constraints) of the financial information

To be able to achieve the objectives of accountability and decision-making usefulness, the information included in GPFRs of public sector entities must have certain attributes. The IPSASB's CF explains that these qualitative characteristics are: **relevance, faithful representation, understandability, timeliness, comparability, and verifiability**,[34] with no particular hierarchy of importance. The IPSASB's CF vastly develops these issues,[35] which may be summarized as follows.

Financial and non-financial information is said to have relevance when it 'makes a difference' in achieving the objectives of financial reporting. In order to be relevant, information must have confirmatory value, predictive value, or both; the confirmatory and predictive roles of information being interrelated (e.g., historical information helps to make judgments about the future). Materiality establishes the quantitative threshold for relevance.

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[34] IPSASB (2014, CF 3.2).

[35] IPSASB (2014, CF 3).

Information must be a faithful representation of the economic and other phenomena that it purports to represent. The presentation of the phenomena must be neutral (neither biased, nor intentionally selected), complete (without material omissions) and as free from error as is possible.[36] Free from error does not mean complete accuracy in all respects; instead, it means there are no errors or omissions individually or collectively material in the description of the phenomenon.

Faithful representation also implies depicting the substance of the underlying transaction, using prudence while making judgments needed under conditions of uncertainty (e.g., in making estimates, such that assets or revenue are not overstated, and liabilities or expenses are not understated); these judgments might not be so neutral.

To be useful, information must also be understood by the users, implying that public sector entities should present information in a manner that responds to the needs and knowledge base of users, and to the nature of the information presented.[37] A certain balance between complexity and simplicity, using plain language, may have to be considered. Also, understandability may be enhanced by comparability. Users are assumed to have reasonable knowledge about the entity and be able to read its financial information.

Information must be made available before it loses its capacity to be useful; if it is delayed, relevance might be jeopardized, so timeliness is a critical quality of financial information. Still, some items may continue to be useful for long periods after the reporting date.

Information must also be comparable (in time and space), allowing users to identify similarities and differences between

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[36] IPSASB (2014, CF 3.14).

[37] IPSASB (2014, CF 3.17).

two sets of phenomena. Comparability is different from consistency and uniformity, although consistency is required to assure comparability.

Finally, information must be verifiable, to help ensuring that it faithfully represents the economic and other phenomena that it purports to represent. Also referred to as 'supportability',[38] verifiability means that information must be supported by evidence, allowing independent observers to reach a consensus that it appropriately reflects the entity's reality. Verification may be done directly (e.g., counting cash), or indirectly (e.g., calculating the carrying amount of inventory).

Materiality and costs *vs* benefits are issues constraining the attainment of the above qualitative characteristics. As also acknowledged by the IPSASB's CF, the balance between the qualitative characteristics themselves is not easy, as they sometimes conflict. Figure 7.2 illustrates these constraints.

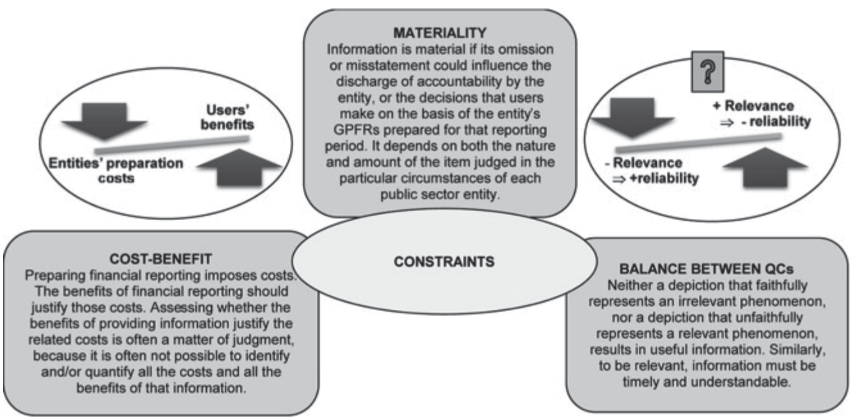

Figure 7.2: Qualitative characteristics – balance and constraints
Source: IPSASB (2014, CF 3.32-3.42)

[38] IPSASB (2014, CF 3.26).

3.4. Elements of the financial statements and their recognition[39]

Financial statements are demonstrations representing the financial and economic reality of a public sector entity. The main financial statements are: statement of financial position, statement of financial performance, cash flow statement, statement of changes in net assets, and notes (*IPSAS 1 – Presentation of financial statements* and *IPSAS 2 – Cash Flow Statements*). IPSAS 1 also requires the preparation of the Budget Execution Statement for public sector entities that publish their budgets. Overall, the financial statements reflect the financial effects of transactions and other events, by grouping them into broad classes which share common economic characteristics – these are called elements of financial statements.

Demonstrating the entity's financial position includes: assets (plus other resources), liabilities (plus other obligations), ownership contributions and ownership distributions. Other resources and other obligations refer to deferred expenses and revenues, respectively. The 'net financial position' presented in this statement, also called Balance Sheet, is

> (...) the difference between assets and liabilities after adding other resources and deducting other obligations recognized in the statement of financial position. Net financial position can be a positive or negative residual amount.[40]

This residual amount is then described in terms of the constituent reserves in another statement, namely, the statement of changes in net assets.

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[39] IPSASB (2014, CF 5 and 6).

[40] IPSAS (2014, CF 5.28).

Revenue and expenses are the elements to demonstrate the entity's financial performance, in a statement where the bottom line is the (accrual-based) deficit or surplus.

Recognizing items in these elements means incorporating them in the amounts displayed on the face of the appropriate financial statements, in accordance with the criteria established in the CF.[41] Overall, recognition criteria require that the item satisfies the definition of the element, and that it can be measured with reliability. Therefore, understanding the definitions of each type of element of the financial statements in the public sector setting is critical, as these identify recognition criteria.

An **asset** is defined as a resource presently controlled by the entity as a result of a past event. A resource is an item with service potential or the ability to generate economic benefits.[42]

Consequently, as in business accounting, also considering the substance over legal form, ownership is not a requirement for an asset to be recognized by a public sector entity. Controlling the resource, instead, is critical, meaning that the entity has the ability to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in it; or to determine the nature and the way other entities make use of the economic benefits generated by the resource.[43] For example, a police department can have a fleet of vehicles under a financial leasing contract – so not legally owned, but it has the complete control over the items, inasmuch as it defines who and how the vehicles are used, and the department is entirely responsible for maintaining the vehicles, as if these were its property. So, the vehicles under a financial leasing contract are recognized as assets.

[41] IPSASB (2014, CF 6).

[42] IPSASB (2014, CF 5.6-5.7).

[43] IPSASB (2014, CF 5.11-5.12).

A past transaction is also a requirement leading to the present control of an asset; it may result from internal development, an exchange (e.g., purchase) or non-exchange transaction (e.g., donation or the exercise of sovereign powers, such as the power to tax.).[44]

The service potential is the distinctive factor in the definition compared to business accounting, given that many assets in the public sector do not generate economic benefits. It refers to the asset's capacity to provide services that contribute to achieving the entity's objectives, without necessarily generating net cash inflows or equivalents for the entity (e.g., recreational, heritage, community, and defense assets),

> (...) which are held by governments and other public sector entities, and which are used to provide services to third parties. Such services may be for collective or individual consumption.[45]

Still, some assets also generate future economic benefits, i.e., cash or equivalent inflows (or a reduction in cash or equivalent outflows), derived from an asset's use in the production and sale of services (e.g., water provision), or from the direct exchange of an asset for cash or other resources (e.g., a piece of land in exchange for offices in a building).[46]

A **liability** is a present obligation of the entity for an outflow of resources, which results from a past event.[47] It has to be a binding obligation (either legally or non-legally), regarding which an entity has little or no realistic alternative to avoid an outflow of resources; therefore, it implies an outflow of resources from the entity for it to

[44] IPSASB (2014, CF 5.13).

[45] IPSASB (2014, CF 5.9).

[46] IPSASB (2014, CF 5.10).

[47] IPSASB (2014, CF 5.14).

be settled, and it is always towards a third party. The obligation may be originated by an exchange or a non-exchange transaction. The past event leading to the present obligation might be more or less straightforward to identify, depending on whether an arrangement has a legal form and is binding, or not.[48] For example, an invoice coming from a contract with a supplier undoubtedly generates a present obligation; however, a legal suit in court may require the entity to assess whether there will be a liability – the outflow might not be certain yet and/or might not be reliably measured.

Therefore, a legal obligation, enforceable in law (even if it may arise from a variety of legal constructs), gives rise to a liability. But, a non-legal (though binding) obligation, because the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement, only gives rise to a liability under certain conditions. These are:[49]

- The entity has indicated to other parties that it will accept certain responsibilities;
- The entity has created a valid expectation of those other parties that it will discharge those responsibilities;
- The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

Accordingly, in a government setting, political promises do not give rise to these types of obligations.

Ownership contributions for the net financial position are inflows of resources of an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the Net Financial Position of that entity. On the other hand, **ownership distributions**

[48] IPSASB (2014, CF 5.15-5.26).

[49] IPSASB (2014, CF 5.23).

from the net financial position are outflows of resources from an entity, distributed to external parties in their capacity as owners, which return or reduce an interest in the Net Financial Position of that entity.[50]

Although these notions are more related to business accounting, they may also apply in public sector organizations, for example, in business-type government entities with shareholders, applying PSA standards. The figure of 'the owner' and ownership interests may arise when one entity contributes resources to provide another entity with the capacity to start operational activities. This is the case in public hospitals in Portugal, which are companies under the business law, owned by the government and subject to the public sector accounting system (main revenues come from taxes and grants).

> In the public sector, contributions to, and distributions from, entities are sometimes linked to the restructuring of government [or of public sector organizations] and will take the form of transfers of assets and liabilities rather than cash transactions.[51]

Ownership distributions may derive from: a return on investment; a full or partial return of investment; or a return of any residual resources, in the event of the entity being wound up or restructured.[52]

Revenue and **expenses** are, respectively, increases or decreases in the net financial position of the entity, other than increases or decreases arising from ownership contributions or distributions.[53]

The entity's surplus or deficit for the period is the difference between revenue and expenses reported in the statement of financial performance (also called the Income Statement or Profit and Loss

[50] IPSASB (2014, CF 5.33-5.37).

[51] IPSASB (2014, CF 5.36).

[52] IPSASB (2014, CF 5.37).

[53] IPSASB (2014, CF 5.29-5.32).

Statement). Revenues and expenses are distinct from cash flows, and their matching to ascertain the surplus or deficit is rather debatable in the public sector, as will be discussed in Chapter 8 of this book.

Revenues and expenses arise from exchange and non-exchange transactions, or from other events, such as: changes in prices and unrealized increases and decreases in the value of assets and liabilities; the consumption of assets through depreciation; and erosion of service potential and ability to generate economic benefits through impairments.[54] Recognizing an item in the financial statements, apart from fulfilling the definition, requires a monetary value to be attached to it. This process entails selecting an appropriate measurement basis, ensuring that the measurement is sufficiently relevant and faithfully representative.[55]

3.5. Measurement criteria[56]

Measuring implies determining the monetary amounts to be used in the valuation of the elements to be recognized in the financial statements, by selecting specific measurement bases.

Regarding the objectives of measurement, the IPSASB instructs that an entity must select measurement bases that most fairly reflect its **cost of services, operational capacity and financial capacity**, and are useful in holding the entity to account and for decision-making purposes.[57] These measurement bases must also provide information that meets the qualitative characteristics.

The CF does not propose a single measurement basis (or combination of bases) for all transactions, events and conditions; instead,

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[54] IPSASB (2014, CF 5.31).

[55] IPSASB (2014, CF 6.7-6.8).

[56] IPSASB (2014, CF 7).

[57] IPSASB (2014, CF 7.2-7.4).

it provides guidance on the selection of a measurement basis for assets and liabilities, based either on the **historical cost** or **current value**, and may be **entry (recognizing) values** or **exit (derecognizing) values.** From this range of criteria, each IPSAS then specifies which basis(es) is(are) to be specifically used. Furthermore, standards sometimes require measures that are not even mentioned in the CF.

Entry values and Exit values

- For **assets**, *entry values* essentially reflect the cost of purchase/acquisition (e.g., historical cost and replacement cost); *exit values* reflect the economic benefits from sale, or the amount that will be derived from use of the asset (e.g., net selling price and value in use).
- For **liabilities**, *entry values* relate to the transaction under which an obligation is received or the amount that an entity would accept to assume a liability; *exit values* reflect the amount required to fulfil an obligation or the amount required to release the entity from an obligation.

Observable and Unobservable Measures

Certain measures may be classified according to whether they are observable in an 'open, active and orderly market' (e.g., market value/fair value), or instead need to be calculated (e.g., value in use).

Observable measures are likely to be more understandable and verifiable than unobservable measures; they may also be more faithfully representative of the phenomena they are measuring.

As displayed in Figure 7.3, there is a large variety of measurement bases suggested. And even if within each standard the options may be reduced, it is a fact that there is too much flexibility and diversity, which jeopardizes the comparability claimed for the IPSAS.

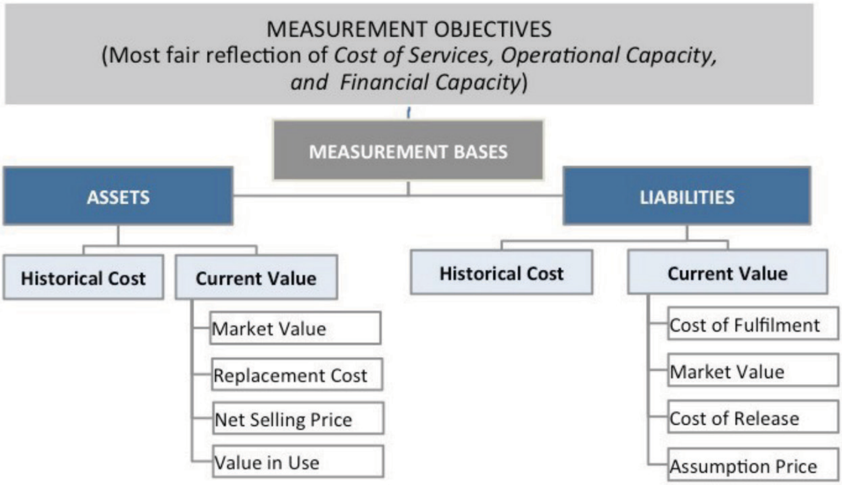

Figure 7.3: Measurement bases
Source: IPSASB (2014, CF 7)

Figure 7.3 shows different criteria regarding the current value of assets and liabilities, though some are mirrored concepts. For example, replacement cost in assets is similar to the assumption price in liabilities. Replacement cost is the amount that the entity would rationally be willing to pay to acquire the asset in its current depreciated state; while the assumption price is the amount that an entity would rationally be willing to accept in exchange for taking on an existing liability. Both are entry criteria, and they may be the most suitable for reflecting either the financial or the operational capacity of the entity.

Likewise, net selling price for assets pairs with cost of release for liabilities; both are exit criteria, and they reflect respectively the amount the entity can obtain from selling the asset (less costs of sale) and the amount the entity would be willing to pay to immediately 'get rid of' the obligation. Contrary to the market value, which may be an exit or entry criteria[58], these criteria do not require an open, active and orderly market or the estimation of a price. Because of this requirement, market value is eventually the least likely applied criterion, as for many assets in the public sector there is no market, and even less so for liabilities.

Value in use as an exit value for assets is often complex to obtain as it implies calculating the net present value of cash flows generated by the assets or, for non-cash generating assets, calculating the remaining service potential (frequently using replacement cost as a surrogate). Its complexity makes it inappropriate to reflect the entity's costs of services and reduces its usefulness in assessing its operational and financial capacity.[59]

Historical cost, an entry criterion both for assets and liabilities, is probably the most suitable for reflecting the entity's cost of services.

4. Comparative analysis of different CFs

This section presents a summarized comparative-international analysis involving the different CFs of selected European countries – Austria, Finland, Germany, Portugal and the UK – taking the one from the IPSASB as reference. These are illustrative examples on how national CFs may approximate or diverge from that of the IPSASB.

The issues to be compared are financial statements (FS) objectives and main users, main accounting principles and methodologies, FS elements and recognition criteria, and measurement criteria used in financial accounting. Table 7.2 provides a synthesis based on Brusca et al. (2015) with some additions from the countries' CFs.

[58] Market value is sometimes confused with fair value used for business accounting. It should be noted that, according to IFRS 13, fair value is only an exit value.

[59] IPSASB (2014, CF 7.63).

COUNTRIES	IPSASB	Portugal	UK	Austria		Finland	Germany
			(IFRS-based)	(Central Govt)	(Regional and Local Govt)		(IF accrual-based accounting)
FS Objectives – provide financial information about an entity/activity for:							
Accountability	X	X	X	X	X	X	X
Decision-making	X	X		X			
Stewardship			X				
Comparability							X
Intergenerational equity							X
Regularity			X				
FS Main Users:							
Citizens (service recipients and tax payers)	X	X	X	X	X	X	X
Politicians in Parliament as representatives of citizens	X	X	X	X		X	X
Central Government					X		
Other resource providers (e.g. investors)	X	X	X	X			
Oversight authorities (e.g. SAI)	X	X		X	X	X	X
Statistics authorities	X	X		X	X	X	X
Politicians in Parliament as voters of resources			X				
Management Board			X				
Audit committees			X				
Main Accounting Principles and Methodologies:							
Accrual regime	X	X	X	X	X	X (matching and revenue realization)	X (with realization of gains and losses)
Substance over legal form	X	X	X	X			X
Going concern	X	X	X	X			X

COUNTRIES	IPSASB	Portugal	UK	Austria		Finland	Germany
True and fair view			X				X
Prudence (conservatism)						X	X
Double entry – financial accounting	X	X	X	X	X	X	X
Double entry – budgetary accounting		X		X	X		
Budgetary reporting within the financial statements	X	X					
Budgetary accounting – cash basis/ commitment		X	X			X (for non-exchange transactions)	X (Central and State level[60])
Budgetary accounting – accrual basis			X	X	X	X (for exchange transactions)	X (Local level[61])
FS Elements:							
Assets	X	X	X	X	X (receivables)	X	X (including deferred expenses)
Liabilities	X	X	X	X	X (payables)	X	X (including deferred revenues)
Owners' contributions	X	X	X	X			X
Owners' distributions	X	X	X	X			X
Net assets/equity	X	X	X	X	X		X
Revenues	X	X	X	X	X	X	X
Expenses	X	X	X	X	X	X	X

60 There may be accrual and cash-based budgeting in parallel at state level (e.g. Hesse).

61 May not apply to all counties and municipalities.

COUNTRIES	IPSASB	Portugal	UK	Austria		Finland	Germany
Deficit/Surplus	X	X	X	X	X	X (income statement-led approach)	X
Recognition criteria:							
Economic control	X	X	X	X	X		X
Measured with reliability	X	X	X	X	X	X (ensured under the cost convention)	X (historical cost)
Consideration of events after the reporting date	X	X	X	X	X		X
Realization principle						X (for exchange transactions)	X
Cash and short-term liability for non-exchange transactions						X	
Measurement criteria in financial accounting:							
Historical cost convention	X	X	X	X	X	X (prudence)	X (cautious prudence)
Fair value is used for certain assets	X	X	X	X	X	X (for financial assets, when lower than cost)	X (when lower than cost)
Fair value is used for certain liabilities	X	X	X	X	X	X (when indexed, and value is higher than face value)	X (when higher than settlement amount)

COUNTRIES	IPSASB	Portugal	UK	Austria		Finland	Germany
Amortized cost is used for certain assets and liabilities	X	X	X	X	X		X (maximum reversal of impairment)
Revaluation for non-current assets	X		X			X (certain assets, e.g. land)	
Depreciation for non-current assets	X	X	X	X	X	X (excluding land)	X
Impairment review for non-current assets	X	X	X	X	X	X (when not depreciated, e.g. land)	X

Table 7.2: Comparative-international analysis of different CFs

Table 7.2 shows fewer differences in users than in objectives, both between countries and compared to IPSAS. Regarding the objectives, in Finland and Germany, accountability is clearly the main purpose; while in UK, providing information for decision-making is not explicitly an objective.

In the case of Austria, the reform followed a top-down process. Since 2013, central government has been going ahead with a considerable reform introducing accruals (IPSAS-based) even in the budget; while at the regional and local level, accrual based GPFS became a requirement starting from the reporting year 2020.

In the case of Germany, the reform has followed a bottom-up process. Starting in local governments (municipalities), many already using accrual accounting, but not IPSAS. At federal and state (*Länder*) levels, in 2009 a reform also started and in 2016 new legislation was passed,[62] giving the option to use either cameralistic (budgetary cash accounting and single entry) or accrual-accounting (but not IPSAS). Currently, only two states (Hesse and North-Rhine Westfalia) use accruals and double entry, plus two city states – Hamburg and Bremen. The government at federal (central) level still uses essentially modernized (extended) cameralistic accounting, meaning cameralistics including product-oriented extensions such as expenditure-revenue data for single reports and budgets (performance budgeting), KPIs built on a comprehensive cost and activity accounting system, and capital account. Therefore, the information in Table 7.2 applies only IF entities use accrual-based accounting, which may not happen in several states, neither in the federation (reforms are ongoing) and smaller municipalities, which still use cameralistic accounting.

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[62] GERMANY, Governmental Accrual Accounting Standards (GAAS) [Standards staatlicher Doppik; SsD]; pursuant to section 7a and section 49a of the Budgetary Principles Act (HGrG); Resolution of 29 November 2016 of the committee pursuant to section 49a HGrG (to be updated on a yearly basis).

Regarding the main accounting principles and methodologies, IPSAS apply to accrual financial accounting, despite the existence of a cash-based IPSAS – *Financial reporting under the Cash Basis of Accounting*. In Table 7.2, in spite of being an IPSAS adopter (with accrual-based financial reporting), Portugal is the only country where budgetary accounting and reporting is cash and commitment-based, with double entry. The UK also uses cash-based annual budgets with some accrual additions. In the other countries (as in the IPSASB framework), an accrual basis is admitted, even in the budget. Accrual-based budgets and budgetary accounting exist in the central government in UK (three-year budget), Austria and Finland, and may be an option in Germany. In German local government, although some small municipalities in specific federal states still use only cameralistic (cash and single entry budgetary) accounting, the majority of those using accrual accounting also prepare an accrual-based budget, in addition to the cash-based one.

A striking feature is that cautious prudence (conservatism) seems to be a clearly prevailing principle in the CFs of Germany and Finland, clearly reflected in several lines in Table 7.2.

Table 7.2 additionally shows that IPSAS-compliant countries (and indirectly the UK) define the elements within the main financial statements.

Finland has an explicit focus on revenue and expenses, the annual reporting following what is called an *income statement-led approach*. The prevalence of the historical cost convention and the realization principle again evidences more conservatism in Finland and in Germany.

The German CF explicitly makes reference to deferred revenues (received in current year and perceived in the following) and expenses (paid in current year and incurred in the following), which also exist in the Balance Sheet of the IPSASB, Portugal, the UK and Austria, but they are not explicitly defined in their CFs.

As to measurement criteria in financial accounting, as expected, Table 7.2 displays (again) more prudent measurement criteria in Finland and in Germany, with no references to fair value and market value, which are admitted for use in exceptional cases only. However, while Finland allows for revaluation of non-current (non-financial) assets in some cases, this is not allowed in Portugal, Austria and Germany. In the case of Portugal, a legal instruction from the central government is required so that revaluation can be authorized.

5. Developments in the IPSASB's CF – work in progress

The IPSASB is in the process of updating its CF[63] originally published in 2014. The update is to reflect the experiences that the Board has gained over time in the process of developing and maintaining IPSAS. The update is also intended to reflect developments in international thinking about conceptual issues. Up to the end of 2022, the IPSASB has issued updates relating to three chapters of the CF, namely, Chapters 3, 5 and 7. However, no changes have been included in the 2022 Edition of the CF.

In February 2022, the IPSASB published Exposure Draft (ED) 81, aimed to revise Chapter 3 – Qualitative Characteristics, and Chapter 5 – Elements in Financial Statements.

With regards to Chapter 3, ED81 is not proposing any changes to the current six qualitative characteristics as described earlier. The ED is proposing enhanced guidance on the role of prudence and on materiality.[64] With regards to prudence, the Board highlights that the exercise of prudence under conditions of uncertainty sup-

[63] Agenda Item 5, Conceptual Framework – Limited Scope Update (CF-LSU) – Phase One: Measurement (Board Papers, June 2022).

[64] See also Lorson and Haustein (2019).

ports neutrality. The exercise of prudence does not imply a need for asymmetry. Individual standards may include asymmetric requirements on a case-by-case basis.[65] As for materiality, the IPSASB acknowledges that obscuring material information is a factor that can have a negative impact on users.

The IPSASB is proposing minor changes in Chapter 5, relating to the definitions of an asset and liability. An asset is defined as a resource presently controlled by the entity as a result of past events. A resource is a right to service potential and/or the capability to generate economic benefits. The ED then proceeds by explaining the definition of a resource in some depth. A liability is a present obligation of the entity to transfer resources as a result of past events. The proposed definition of a liability, thus, moves away from using the phrase “an outflow of resources”. In tandem to this, in Chapter 5, ED 81 also proposes new guidance on a transfer of resources (instead of that currently provided on an outflow of resources); unit of account (which could be either singular or a group of rights and obligations); and binding arrangements that are equally underperformed by both parties.

The Board aims to finalize and publish these updates to Chapters 3 and 5 by April 2023.

Another important task was undertaken in April 2021, with the publication of ED76 relating to Chapter 7 – Measurement of Assets and Liabilities in Financial Statements. According to the IPSASB meeting held in June 2022, the Board was planning to approve the revised Chapter 7 in September 2022; however, there was no clear indication of its intended publication.

ED76 introduces a measurement hierarchy that seeks to explain how the various components required to estimate the value of an asset or liability interact in the context of IPSAS. The measurement hierarchy identifies three levels of measurement as illustrated in Figure 7.4.

[65] See the case study presented by Adam et al. (2022).

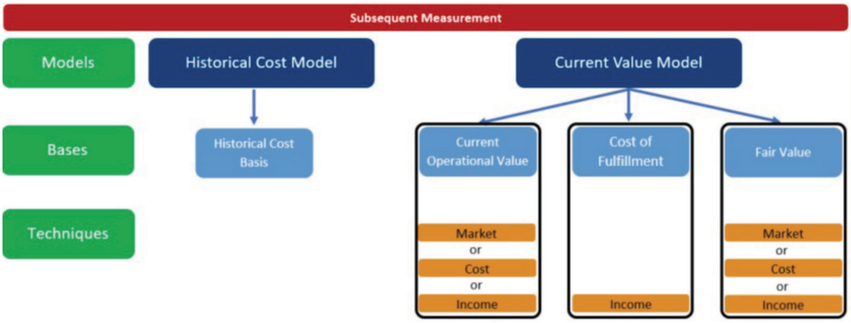

Figure 7.4: The Measurement Hierarchy proposed by ED76

The IPSASB is thus introducing a new term, namely, Current Operational Value. This measurement basis is developed to capture the unique characteristics of assets held by public sector entities, which provide challenges to the application of fair (market) value measurement. The current operational value attempts to measure public sector assets in their current use when held for their operational capacity. Operational capacity is defined as the capacity of an entity to support the provision of services in future periods through physical and other sources.

However, a degree of uncertainty underlies this new measurement basis as the ED proposes two definitions. The definition of Current Operational Value proposed by ED76 is "the value of an asset used to achieve the entity's service delivery objectives at the measurement date" (paragraph 7.48). The alternative definition is "the cost to replace the service potential embodied in an asset at the measurement date" (paragraph AV3).

Due to the mixed responses received from the constituents, further work is deemed necessary on public sector specific current value of assets primarily held for operational capacity. Some of the responses favored replacement cost, while others supported fair value (as in IPSAS 41 *Financial Instruments* / IFRS 13 *Fair Value*). Thus, at the time of writing, current operational value is an open saga for the IPSASB.

The current state of affairs on ED76 and Chapter 7 of the IPSASB's CF, according to the IPSASB's documentation, is to remove the following measurement terms from the CF: assumption price; cost of release; and net selling price. These are not considered relevant for the public sector context. Issues and contradictions also underlie measurement terms like "value in use" and "replacement cost". These arguments are being dealt with by the IPSASB as part of its ongoing Measurement Project[66]. In fact, ED76 was accompanied by three other EDs relating to measurement, namely:

- ED 77 Measurement;
- ED 78 Property, Plant and Equipment; and
- ED 79 Non-Current Assets Held for Sale and Discontinued Operations.

In May 2022, ED 79 materialized as a new standard, namely IPSAS 44. In December 2022, the IPSASB announced that it has approved the changes proposed by the other EDs relating to the CF and the Measurement project. However, the final result will be published during 2023. Of course, it is expected that the final result from these EDs is coherent with the outcome from ED 76.

6. Conclusion

While closely following the IPSASB's CF, and referring to this as much as possible, this chapter addressed CFs overall, namely their contents in the public sector setting: objectives and users, and qualitative characteristics of financial information; elements of financial statements, and their recognition and measurement criteria.

[66] Caruana (2021).

It called attention to the importance of a CF as an accounting theory. When standards derive from practice, there is a need to have a common theoretical basis to give consistency to practices. However, the extent that the CF does represent accounting theory is highly debatable because there is lack of consistency in the interpretation and application of certain principles. Standard-setters may have used CFs to legitimize their own activities.

The chapter likewise explained that CFs for PSA have derived from those in business accounting, but they have been adapted due to context specifics that may entail different users and users' needs of public sector organizations' financial information.

Accountability is an almost natural purpose of GPFRs of public sector entities in democratic regimes, but the IPSASB establishes that decision making is also an important purpose. Some more critical literature has raised questions not only about who the real users of public sector entities' financial statements are, but also about their needs, underlining the fact that most of the CFs have adopted prescriptive and normative, rather than empirical, approaches.

Qualitative characteristics of financial information are also a part of a CF. These attributes are crucial to determine the usefulness of that information; however, balancing between them is not an easy task, as they often conflict.

As to the elements of financial statements, although similarities can be found to those in business accounting, again public sector context specifics require particularities in the definitions, impacting on their recognition, and especially on their measurement criteria.

Acknowledging the above, the IPSASB recently embarked in revising the CF, assigning special importance to measurement issues. The IPSASB's Measurement Project promises to continue.

Finally, despite the international reference of the IPSASB's CF, not all countries necessarily follow it, as they do not follow IPSAS.

Countries with very deep-rooted accounting national traditions, such as Germany and Finland, tend to diverge from the IPSASB's perspective – even if some of their principles and concepts may approach it, a more conservative attitude is clear.

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Discussion topics

– What is the role of a CF compared to that of PSA standards?

– What are the main objectives and who are the main users of financial (and budgetary) information reported by public sector entities, according to the different CFs presented in this chapter (comparative-international perspective)?

– What are the main recognition criteria for assets, liabilities, expenses and revenues, according to the different

CFs presented in this chapter (comparative-international perspective)?
- Distinguish the main criteria which can be used to measure assets, liabilities, expenses and revenues within the financial statements, according to the different CFs presented in this chapter (comparative-international perspective).
- Referring to the Table 7.2 in Section 4, add data that is applicable for your jurisdiction, either at local, state or central government level.

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